

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF )  
DELMARVA POWER & LIGHT COMPANY FOR ) PSC DOCKET NO. 11-528  
AN INCREASE IN ELECTRIC BASE RATES )  
AND MISCELLANEOUS TARIFF CHANGES )  
(FILED DECEMBER 2, 2011) )

DIRECT TESTIMONY OF  
  
DAVID E. PETERSON  
  
ON BEHALF OF  
  
COMMISSION STAFF

May 15, 2012

**I. INTRODUCTION**

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**Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.**

A. My name is David E. Peterson. I am a Senior Consultant employed by Chesapeake Regulatory Consultants, Inc. ("CRC"). Our business address is 1698 Saefern Way, Annapolis, Maryland 21401-6529. I maintain an office in Dunkirk, Maryland.

**Q. WHAT IS YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE IN THE PUBLIC UTILITY FIELD?**

A. I graduated with a Bachelor of Science degree in Economics from South Dakota State University in May of 1977. In 1983, I received a Master's degree in Business Administration from the University of South Dakota. My graduate program included accounting and public utility courses at the University of Maryland.

In September 1977, I joined the Staff of the Fixed Utilities Division of the South Dakota Public Utilities Commission as a rate analyst. My responsibilities at the South Dakota Commission included analyzing and testifying on ratemaking matters arising in rate proceedings involving electric, gas and telephone utilities.

Since leaving the South Dakota Commission in 1980, I have continued performing cost of service and revenue requirement analyses as a consultant. In December 1980, I joined the public utility consulting firm of Hess & Lim, Inc. I remained with that firm until August 1991, when I joined CRC. Over the years, I have analyzed filings by electric, natural gas, propane, telephone, water, wastewater, and steam utilities in connection with utility rate and certificate proceedings before federal and state regulatory commissions.

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1   **Q.   HAVE YOU PREVIOUSLY PRESENTED TESTIMONY IN PUBLIC**  
2   **UTILITY RATE PROCEEDINGS?**

3   A.   Yes.  I have presented testimony in 131 other proceedings before the state  
4       regulatory commissions in Alabama, Arkansas, Colorado, Connecticut, Delaware,  
5       Indiana, Kansas, Maine, Maryland, Montana, Nevada, New Jersey, New Mexico,  
6       New York, Pennsylvania, South Dakota, West Virginia, and Wyoming, and  
7       before the Federal Energy Regulatory Commission.  Collectively, my testimonies  
8       have addressed the following topics:  the appropriate test year, rate base,  
9       revenues, expenses, depreciation, taxes, capital structure, capital costs, rate of  
10      return, cost allocation, rate design, life-cycle analyses, affiliate transactions,  
11      mergers, acquisitions, and cost-tracking procedures.

12  
13      In addition, in 2006 testified twice testified before the Energy Subcommittee of  
14      the Delaware House of Representatives on the issues of consolidated tax savings  
15      and tax normalization.  Also in 2006, I presented a one-day seminar to the  
16      Delaware Public Service Commission (“Commission”) on consolidated tax  
17      savings, tax normalization and other utility-related tax issues.  In the spring of  
18      2011, I co-presented along with Mr. Scott Hempling, the then-director of NRRI, a  
19      three-day seminar on public utility ratemaking principles and issues to the  
20      Commissioners and Staff of the Washington Utilities and Transportation  
21      Commission.

**II. SUMMARY**

**Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

A. My appearance in this proceeding is on behalf of the Public Service Commission Staff (“Commission Staff”).

**Q. HAVE YOU TESTIFIED IN OTHER PROCEEDINGS BEFORE THE DELAWARE PUBLIC SERVICE COMMISSION?**

A. Yes, I have. I submitted testimony in rate proceedings involving Delaware Electric Cooperative (Docket No. 04-288), Delmarva Power & Light Company (Docket No. 05-304), and Tidewater Utilities, Inc. (Docket No. 06-145). Each of my appearances in these proceedings was on behalf of the Commission Staff.

**Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

A. I was asked to assist the Commission Staff in analyzing Delmarva Power & Light Company’s (“Delmarva” or “the Company”) rate increase request and proposed rate changes for its electric distribution services in Delaware. Specifically, I was asked to prepare a detailed analysis of Delmarva’s retail electric rate base and *pro forma* operating income under rates that are currently in effect. From these determinations I calculated Delmarva’s present revenue deficiency. The purpose of my testimony is to present the results of my analysis to the Commission and to recommend alternative ratemaking treatments for several items included in the Company’s claimed revenue requirement.

**Q. PLEASE IDENTIFY THE WITNESSES WHO WILL BE TESTIFYING FOR THE COMMISSION STAFF IN THIS PROCEEDING.**

A. In addition to me, the Commission Staff is sponsoring five other witnesses who address different aspects of Delmarva’s filing. Mr. David C. Parcell’s testimony presents the Commission Staff’s recommendations on the appropriate capital

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1 structure, capital cost rates and rate of return. Mr. Michael McGarry is testifying  
2 on Delmarva's inter-company allocation procedures and service levels. Mr. Gary  
3 Cohen's testimony addresses the future recovery of AMI deployments costs and  
4 related tariff changes. Mr. Matthew Hartigan addresses customer care issues. Mr.  
5 Karl Pavlovic addresses alternative ratemaking mythologies, class cost of service  
6 and rate design issues in his testimony.

7  
8 **Q. ARE YOU FAMILIAR WITH DELMARVA'S FILING IN THIS**  
9 **PROCEEDING?**

10 A. Yes, I am. I have carefully reviewed the Direct Testimonies and Exhibits  
11 sponsored by the Company's witnesses relating to the issues that I address herein.  
12 I also reviewed the Company's responses to data requests of the Commission  
13 Staff and the Department of Public Advocate, again relating to the issues that I  
14 address in my testimony

15  
16 **Q. PLEASE SUMMARIZE DELMARVA'S RATE REQUEST.**

17 A. Delmarva's existing retail electric distribution rates have been in effect since  
18 August 2011 when the Commission approved a \$16,371,203 annual revenue  
19 increase for Delmarva in Docket No. 09-414.

20  
21 On December 2, 2011, Delmarva filed an Application with the Commission  
22 requesting a \$31,760,741 or 4.97 percent annual revenue increase. However,  
23 since this proceeding addresses only Delmarva's retail distribution rates, the  
24 Company's proposal is more accurately stated as an 18.9 percent increase over  
25 existing revenues. It should also be noted that the current increase comes on the  
26 heels of a \$16 million increase implemented in August 2011. Thus, Delmarva is  
27 seeking to increase customer rates by over 25 percent in less than a year.  
28 Delmarva's present rate request is premised on a test period ended December 31,  
29 2011, and includes a 10.75 percent return on common equity and a 7.87 percent  
30 return on rate base. Delmarva initially requested that its proposed rates become

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1 effective January 31, 2011. The Commission has suspended the effective date,  
2 however, allowing Delmarva by statute to put the rates into effect in July 2012,  
3 eleven months after the last rate increase, subject to refund.  
4

5 Delmarva's December 2, 2011 filing included a revenue requirement study based  
6 on six month of actual and six months of forecasted operating results. On March  
7 2, 2012, Delmarva supplemented its initial filing to include an updated revenue  
8 requirement analysis. In the updated analysis, the Company replaced the  
9 forecasted operating results with actual operating results. Delmarva's updated  
10 analysis purports to prove a \$33,186,072 annual revenue deficiency (a 19.6  
11 percent increase over existing rates).  
12

13 **Q. HAVE YOU PREPARED AN EXHIBIT SUMMARIZING YOUR**  
14 **RECOMMENDATIONS AND ADJUSTMENTS RELATIVE TO THE**  
15 **COMPANY'S CLAIMED REVENUE REQUIREMENT?**

16 **A.** Yes, I have. Exhibit\_\_\_(DEP-1) attached to my testimony summarizes the  
17 Commission Staff's determination of Delmarva's retail distribution revenue  
18 deficiency. Exhibit\_\_\_(DEP-1), Schedule 1 summarizes the cumulative effect of  
19 my recommendations and adjustments, and those of the Commission Staff's other  
20 witnesses, on Delmarva's March 2, 2012 updated revenue requirement analysis.  
21 From this schedule, I calculated that Delmarva's current retail electric distribution  
22 rates produce a 5.52 percent return on rate base. Commission Staff witness Mr.  
23 Parcell is testifying in this proceeding that Delmarva requires a 7.28 overall return  
24 on rate base. Mr. Parcell's overall return includes a 9.55 percent allowance on  
25 common equity capital. Therefore, on my Schedule 1, I show that Delmarva's  
26 annual revenues will have to be increased by \$15,883,075 in order to yield the  
27 7.28 percent overall return that Mr. Parcell recommends, rather than the \$31.8  
28 million increase that Delmarva originally requested.  
29

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1 Exhibit\_\_\_\_(DEP-1), Schedule 2, is a multi-page schedule detailing my  
2 determination of Delmarva's adjusted average rate base. Schedule 3 shows my  
3 calculation of Delmarva's *pro forma* earnings under present rates. The  
4 Commission Staff's recommended adjustments that bridge Delmarva's updated  
5 revenue requirement analysis to the Commission Staff's *pro forma* determination  
6 are shown in Column C on the first page of Schedules 2 and 3. The bases for the  
7 Commission Staff's recommended rate base and expense adjustments are set forth  
8 in the following sections of my testimony and in the testimonies of the  
9 Commission Staff's other witnesses.

**III. RATE BASE**

**A. Test Period**

14 **Q. WHAT TEST PERIOD IS REFLECTED IN DELMARVA'S UPDATED**  
15 **REVENUE REQUIREMENT ANALYSIS?**

16 A. Delmarva's filing is based on an actual test period consisting of the twelve  
17 months ended December 31, 2011. An actual test period, such as the one used in  
18 Delmarva's revenue requirement cost study, is preferable to a forecasted test  
19 period because an actual test period is based on actual, audited operating results.  
20 A test year based on financial forecasts, on the other hand is unreliable and  
21 unverifiable. Therefore, I used the same actual test period in my calculation of  
22 the Company's revenue requirement that Delmarva used.

24 **Q. DOES DELMARVA'S UPDATED REVENUE REQUIREMENT**  
25 **ANALYSIS INCLUDE ANY ADJUSTMENTS TO ACTUAL TEST**  
26 **PERIOD OPERATING RESULTS?**

27 A. Yes, it does. Delmarva witnesses Messrs. VonSteuben and Ziminsky proposed  
28 several adjustments to the actual test period average rate base, revenues and  
29 expenses to reflect both known and forecasted changes in operating levels.

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1   **Q.    IS IT APPROPRIATE TO ADJUST ACTUAL TEST PERIOD RESULTS?**

2    A.    Yes, under certain conditions. It may be necessary to conform a utility's financial  
3           statements to the regulatory commission's ratemaking practices and accounting  
4           requirements. It may also be appropriate to eliminate nonrecurring transactions  
5           that occurred during the test period, to purge test period results for transactions  
6           that occurred outside of the test period and to "normalize" or smooth abnormal  
7           test period transactions. Finally, it may be appropriate to annualize changes that  
8           occurred during the test period and to recognize post-test year changes provided  
9           they have a continuing effect on operations and are known and measurable, and  
10          do not distort the test period matching principle. These types of adjustments  
11          make an actual test period reasonably representative of the conditions that are  
12          likely to exist when the revised rates become effective. Such adjustments provide  
13          the utility a reasonable opportunity to earn its authorized rate of return.

14  
15          **B.      Reliability Closings**

16   **Q.    IS MR. VONSTEUBEN PROPOSING ANY ADJUSTMENT TO THE TEST**  
17          **PERIOD THIRTEEN-POINT AVERAGE RATE BASE BALANCES**  
18          **RECORDED ON THE COMPANY'S BOOKS?**

19    A.    Yes, he is. Mr. VonSteuben is proposing two types of rate base adjustments for  
20           plant closings, both during and after the test period, for what he calls "reliability"  
21           facilities. With respect to reliability plant additions that were completed and  
22           added to service during the test year, rather than including their investment  
23           balances in the thirteen-point average calculation, Mr. VonSteuben annualized  
24           their balance as of the end of the test period. In other words, Mr. VonSteuben's  
25           proposed rate base reflects year-end rate base treatment for test period reliability  
26           plant additions. In addition, Mr. VonSteuben also added to rate base both actual  
27           and forecasted reliability plant additions, net of forecasted reliability retirements,  
28           through June 2012. The combined effect of Mr. VonSteuben's year-end  
29           annualized and post-test year reliability plant additions is to increase rate base by



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1       \$20,057,826 and to reduce *pro forma* operating income under present rates by  
2       \$821,645.

3  
4       **Q.     ARE MR. VONSTEUBEN'S RELIABILITY PLANT ADJUSTMENTS**  
5       **APPROPRIATE?**

6       A.     No. Both adjustments constitute violations of the test period matching principle  
7       in that both adjustments create a mismatch between plant investment and the  
8       revenues and expenses that flow from that plant investment. In so doing,  
9       calculating earnings under present rates using the year-end plant investment and  
10      the post-test year plant additions will result in an understatement of the earnings  
11      capability of Delmarva's present rates. The matching principle requires that test  
12      period revenues and expenses be compared with plant in service throughout the  
13      test period – i.e., the thirteen point average. Mr. VonSteuben's reliability plant  
14      adjustments distort the test year relationship between plant in service and other  
15      elements of the revenue requirement. The distortion can easily be identified in the  
16      accumulated reserves for depreciation and deferred taxes. While Mr.  
17      VonSteuben's adjustments recognize the increasing reserves for depreciation and  
18      deferred income taxes associated with reliability plant additions, his adjustments  
19      completely ignore the growth in the depreciation reserve for embedded plant that  
20      will be occurring as the reliability plant is placed in service. Also, his adjustments  
21      fail to annualize the effects on the deferred tax reserve arising from bonus tax  
22      depreciation on non-reliability plant closings in 2011. In effect, all elements of  
23      the test year revenue requirement would have to be restated to June 30, 2012 for  
24      the proper matching result to be achieved. Clearly, this is not what Mr.  
25      VonSteuben had in mind; nor do I recommend it. Rather, I recommend that rate  
26      base reflect only plant in service during the test year calculated using a thirteen-  
27      point average. My adjustments to reverse Mr. VonSteuben's proposed reliability-  
28      related rate base adjustments are shown on my Exhibit\_\_\_\_(DEP-1), Schedule 2,  
29      page 2, Columns B, C, and D.

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**C. Construction Work In Progress**

**Q. IN ADDITION TO THE POST-TEST YEAR RELIABILITY PLANT ADDITIONS THAT YOU JUST DISCUSSED, DID THE COMPANY INCLUDE IN RATE BASE ANY OTHER PLANT THAT WAS NOT IN SERVICE DURING THE TEST PERIOD?**

**A.** Yes, it did. In addition to the forecasted reliability additions through June 2012, Delmarva's proposed rate base also includes \$29,740,803 of construction work in progress ("CWIP").

**Q. IN YOUR OPINION, IS IT APPROPRIATE TO INCLUDE CWIP IN DELMARVA'S RATE BASE?**

**A.** No, it is not. It has been my consistent position that plant that is not used and useful during the test period should not be included in rate base. My position on this applies to the projected post-test year reliability plant closings and to the other CWIP included in Delmarva's claimed rate base. My primary objection to including the post-test year reliability plant closings and CWIP in rate base is that the construction projects in question were not used and useful during the test period. Delmarva's customers received no service benefits from them. More fundamentally, including CWIP in rate base violates the test period matching principle. It does so by stepping outside the test period to measure investment without making similar out of period adjustments for revenues and expenses that flow from the out of period investment. Once it is placed in service, the distribution CWIP that Mr. VonSteuben has included in his rate base presentation will serve new customers or new loads, increase operating efficiency or service reliability, or decrease maintenance requirements on both new and existing facilities. Yet, none of these revenue increasing or expense reducing impacts that flow from CWIP (and the reliability projects) are reflected in Mr. VonSteuben's revenue requirement determination. In other words, Mr. VonSteuben's rate base treatment for CWIP recognizes only the cost increases that flow from the post-test period construction projects, but it does not recognize the service benefits (i.e.,

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1 increasing revenues and reducing expense) that flow from CWIP. Because of this  
2 mismatch, CWIP should not be included in Delmarva's rate base. My position is  
3 consistent with the last several Commission decisions regarding Delmarva's rate  
4 base and CWIP. (*See*, Commission Order Nos. 8011 and 6039.)  
5

6 **Q. HOW THEN IS DELMARVA TO BE COMPENSATED FOR FINANCING**  
7 **COSTS INCURRED DURING THE CONSTRUCTION PERIOD IF CWIP**  
8 **IS NOT INCLUDED IN RATE BASE?**

9 A. Delmarva is appropriately compensated for construction period financing costs  
10 when it capitalizes an allowance for funds used during construction ("AFUDC").  
11 Once capitalized, accumulated AFUDC is added to other construction-related  
12 costs in Account 101, Plant in Service, and is depreciated over the useful life of  
13 the asset.  
14

15 **Q. MR. VONSTEUBEN ADDED AFUDC TO OPERATING INCOME IN**  
16 **THIS PROCEEDING. DOESN'T INCLUDING AFUDC IN CURRENT**  
17 **EARNINGS OFFSET THE REVENUE REQUIREMENT IMPACT OF**  
18 **INCLUDING CWIP IN RATE BASE?**

19 A. In theory, if the AFUDC rate matched Delmarva's authorized rate of return and if  
20 Delmarva capitalized AFUDC on all construction projects, then including  
21 AFUDC in current earnings would offset the revenue requirement impact of  
22 including CWIP in rate base. But this is not the case in this proceeding. After  
23 considering the effects of Mr. VonSteuben's reliability plant closing adjustments,  
24 his rate base determination has \$29,740,803 of CWIP and his income statement  
25 has only \$575,892 of AFUDC. This level of AFUDC has an effective earnings  
26 rate of only 1.94 percent on the CWIP balance. This earnings rate is far below the  
27 7.87 percent overall rate of return that Delmarva is requesting in this proceeding.  
28 Therefore, including AFUDC in current earnings does not come close to  
29 offsetting the revenue requirement impact of including CWIP in rate base. (*See*,  
30 Commission decisions cited above.)

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1

2     **Q.     WHAT REASONS ARE THERE FOR THE LOW AFUDC EARNINGS**  
3     **RATE ON DELMARVA’S CWIP BALANCE?**

4     A.     There are at least two reasons for this. First, short-term debt is not included in the  
5             Company’s capital structure for rate setting purposes. Rather, short-term debt is  
6             assigned to CWIP in the calculation of the AFUDC rate. Short-term debt rates  
7             presently are very low. This results in an AFUDC rate that is lower than the  
8             authorized overall rate of return. Second, Mr. VonSteuben testifies that Delmarva  
9             does not capitalize AFUDC on construction projects of short duration and on  
10            those projects that have low per unit costs.

11

12    **Q.     CAN ANYTHING BE DONE TO MAKE AFUDC MORE**  
13    **COMPENSATORY TO THE COMPANY?**

14    A.     Yes. Mr. VonSteuben proposed two solutions. His first recommendation is to  
15             include CWIP in rate base. I have already stated my objection to this approach.  
16             His alternative recommendation is to accrue a carrying charge on all CWIP.  
17             Under Mr. VonSteuben’s alternative recommendation, the difference between the  
18             accrued carrying charge and the actual amount of AFUDC that is recorded on the  
19             Company’s books would be treated as a regulatory asset and amortized over the  
20             service lives of the related construction projects once they are completed and  
21             placed into service. Although better than his first alternative, a more  
22             straightforward approach would be for Delmarva to change its AFUDC  
23             capitalization policies so that it actually capitalizes AFUDC on all projects. In  
24             that way, there would be no need for Delmarva to create and track the regulatory  
25             assets that are created under Mr. VonSteuben’s alternative recommendation.

26

27            **D.     Cash Working Capital**

28    **Q.     ARE YOU RECOMMENDING ANY ADJUSTMENTS TO DELMARVA’S**  
29    **PROPOSED CASH WORKING CAPITAL ALLOWANCE?**

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1     A.     Yes, I am. I have accepted the revenue and expense lead and lag days reflected in  
2           the Company's working capital analysis. My adjustments merely reflect the  
3           consequences of my expense adjustments on the cash working capital allowance  
4           sponsored by Delmarva. My cash working capital adjustments, which increases  
5           rate base by \$702,286, are summarized on my Exhibit\_\_\_\_(DEP-1), Schedule 2,  
6           page 3.  
7

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**E. OTHER RATE BASE ADJUSTMENTS**

**Q. PLEASE SUMMARIZE THE COMMISSION STAFF'S OTHER RATE BASE ADJUSTMENTS THAT YOU SHOW ON YOUR EXHIBIT\_\_\_(DEP-1), SCHEDULE 2, PAGES 2A AND 2B.**

**A.** In addition to the rate base adjustments that I previously described in my testimony, I am also recommending the following rate base adjustments:

- Capitalized Labor                      \$ 441,812
- Credit Facility                         \$ (665,071)
- Hurricane Irene                      \$ (1,649,968)
- Deferred IRP Costs                   \$ (57,474)
- Deferred RFP Costs                  \$ (28,631)
- Qualified Fuel Cell Provider       \$ (284,423)

The justification for each adjustment is provided in the next section of my testimony.

**F. Rate Base Summary**

**Q. PLEASE SUMMARIZE YOUR RECOMMENDED RATE BASE.**

**A.** Delmarva's updated test period revenue requirement analysis includes a \$598,613,437 rate base. My rate base adjustments, which are summarized on Exhibit\_\_\_(DEP-1), Schedule 2, page 2, reduce Delmarva's claimed rate base by \$64,773,958. I recommend that the Commission set Delmarva's rate base at \$533,839,479, as detailed on my Exhibit\_\_\_(DEP-1), Schedule 2, page 1.

**V. EARNINGS UNDER CURRENT RATES**

**Q. WHERE IN EXHIBIT \_\_\_(DEP-1) DO YOU SHOW THE COMMISSION STAFF'S ADJUSTMENTS TO DELMARVA'S CALCULATION OF *PRO FORMA* INCOME UNDER PRESENT RATES?**

**A.** All of the Commission Staff's income adjustments are summarized on Exhibit \_\_\_(DEP-1), Schedule 3, pages 2, 2a, 2b, 2c and 2d. These schedules show the revenue, expense, tax and net income effects of the Commission Staff's adjustments to Delmarva's updated test year presentation in this proceeding. The remaining pages in Schedule 3 detail the development of our adjustments.

**A. Reliability Plant Closings**

**Q. PLEASE EXPLAIN THE SERIES OF ADJUSTMENTS THAT YOU MADE FOR RELIABILITY PLANT CLOSINGS ON YOUR SCHEDULE 3, PAGE 2A, COLUMNS B, C, AND D.**

**A.** Earlier in my testimony I explained my opposition to Mr. VonSteuben's year-end annualized rate base adjustment for test year reliability plant closings and his inclusion of post-test year plant closings in rate base. In that section of my testimony I described my adjustments to reverse Mr. VonSteuben's proposed rate base additions. In Schedule 3 of my revenue requirement exhibit I reverse Mr. VonSteuben's proposed operating income adjustments associated with the reliability year-end annualization and post-test period plant closings.

**B. Regulatory Commission Expense**

**Q. WHAT ALLOWANCE FOR REGULATORY COMMISSION EXPENSE IS INCLUDED IN DELMARVA'S UPDATED REVENUE REQUIREMENT ANALYSIS?**

**A.** Mr. VonSteuben proposed a set of adjustments that result in a \$285,554 annual allowance for regulatory commission expense. The allowance for non-rate case regulatory commission expense is \$60,554 and was calculated using a three-year

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1 average of actual expenses. Delmarva's proposed expense allowance also  
2 includes the Company's estimate of its costs for this rate proceeding (\$675,000)  
3 amortized over three years, or \$225,000 per year.

4  
5 **Q. ARE YOU RECOMMENDING ANY ADJUSTMENTS TO DELMARVA'S**  
6 **PROPOSED REGULATORY COMMISSION EXPENSE ALLOWANCE?**

7 **A.** Yes, I am recommending two adjustments to Delmarva's estimate of costs  
8 associated with processing this rate case. First, I recommend an adjustment to  
9 remove the \$65,000 cost estimate for Ms. Cannell's participation in this  
10 proceeding so that her charges are not imposed on Delaware ratepayers. Her  
11 testimony in this proceeding is on behalf of and for the benefit of PHI investors.  
12 Therefore, since investor welfare is her primary concern in this proceeding, as  
13 opposed to an even balance of investor and ratepayer interests which is typically  
14 the goal in rate proceedings, investors rather than ratepayers should pay for her  
15 participation. This adjustment reduces Delmarva's requested annual expense  
16 allowance by \$21,667 (\$65,000 divided by 3years).

17  
18 In addition, I reduced the balance of the Company's estimated rate case expense  
19 cost by 25 percent. Delmarva's request is based on estimates from its outside  
20 legal counsel and consultants on the cost of a fully litigated case. I note that  
21 \$135,000 for a cost of capital witness, who is collecting a similar amount in the  
22 other jurisdictions that he is testifying on behalf of Delmarva, seems excessive.  
23 Also, there is no evidence to date that Delmarva has used outside counsel in the  
24 preparation or filing of testimony in this case. Strictly speaking, these estimates  
25 do not qualify as a known and measurable expense. No one can know now with  
26 certainty the precise level of costs the Company will incur in this rate case. I  
27 suspect that the Company's estimate is on the high side. Therefore, I reduced  
28 Delmarva's estimate by an additional 25 percent, excluding Ms. Cannell's fees  
29 and expenses. The sum of my two adjustments to regulatory commission expense  
30 reduces the Company's proposed allowance by \$53,750. My regulatory



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commission expense adjustments are detailed on Schedule 3, page 3 of my revenue requirement exhibit.

**C. Uncollectible Accounts**

**Q. WHAT INCREASE IN UNCOLLECTIBLE ACCOUNTS EXPENSE IS REFLECTED IN DELMARVA'S REVENUE REQUIREMENT STUDY?**

A. During the 2011 test year, Delmarva expensed \$1,246,170 for uncollectible accounts (non-SOS). Mr. VonSteuben included a \$1,611,682 allowance in the Company's proposed revenue requirement. Mr. VonSteuben's \$365,512 expense adjustment is based on the average of the Company's actual uncollectible accounts expense over the last three years. Delmarva's actual uncollectible accounts expense in each of the last three years is as follows:

Twelve months ended December 31, 2009	\$2,102,515
Twelve months ended December 31, 2010	\$1,486,359
Twelve months ended December 31, 2011	\$1,246,170

**Q. DO YOU AGREE WITH MR. VONSTEUBEN'S PROPOSED ADJUSTMENT, WHICH AVERAGES UNCOLLECTIBLE ACCOUNTS EXPENSE OVER THE LAST THREE YEARS?**

A. No, not entirely. It is not uncommon that uncollectible accounts expenses be normalized in rate cases because the actual expense can be unpredictable and can vary randomly, both positively and negatively, and significantly year-by-year. I understand that in prior cases, the Commission has approved using a three-year average, such as the one that Mr. VonSteuben is recommending in this proceeding. Random and significant variances experienced in the account year-by-year are what justifies using a multi-year average normalization approach for rate setting purposes. But, the facts in this case do not support the traditional three-year average approach for this expense.

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1 As we can see from the three-year actual expenses shown above, the amount of  
2 the uncollectible accounts expense has declined in each successive year. That is,  
3 the variance has not been random. Thus, a good argument can be made for  
4 simply relying on the actual test year expense for rate setting purposes in this  
5 case. However, on the chance that Delmarva's test year uncollectible accounts  
6 expense was abnormally low, I recommend using the most recent two-year  
7 average of the Company's actual expense, instead of the three-year average. The  
8 two-year average that I recommend gives appropriate recognition to the actual  
9 expense incurred during the test year while not improperly weighting the average  
10 with the uncollectible accounts expense incurred in 2009, which now seems  
11 abnormally high. My adjustment, which is detailed on my Schedule 3, page 4,  
12 reduces Delmarva's claimed retail distribution O&M expenses by \$245,417.

13

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**D. Capitalized Labor**

**Q. DO ALL OF DELMARVA'S LABOR COSTS GET CHARGED TO CURRENT OPERATING COSTS?**

A. No, they do not. Each year, Delmarva charges over 40 percent of its total labor costs to capital (construction) accounts and to non-utility operations. The following table shows the percentage of total labor costs, excluding service company labor, that were charged to Delmarva's current operations each year during the five-year period 2007 through 2011.

**Percentage of Labor Costs Charged To Current Operations**

2007	55.09%
2008	54.22%
2009	53.34%
2010	56.40%
2011	57.64%

Five-Year Avg.      55.34%

**Q. IS THERE ANYTHING UNUSUAL OR ABNORMAL ABOUT THE AMOUNT OF LABOR COSTS THAT WERE CHARGED TO CURRENT OPERATIONS DURING THE 2011 TEST YEAR.**

A. Yes. The table above clearly shows that Delmarva's labor expense to total labor cost ratio (57.64 percent) was abnormally high during the 2011 test year. That is, a greater percentage of labor costs were charged to current operations during the test year than has been charged to current operations in any other year over the last five years. In fact, the expense ratio has been as low as 53.34 percent as recently as 2009. Because the 2011 expense ratio is significantly higher than average, I recommend that the test year labor expense amount be adjusted to reflect a more normal expense ratio. The adjustment that I detail in my Schedule 3, page 5 normalizes the test year labor expense ratio to reflect the five-year average (55.34 percent). Delmarva's actual labor expense ratio was 2.30 percent higher than the five-year average. Therefore, I recommend that test year labor

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1 expenses be reduced by 2.30 percent or \$837,956, as shown on my Schedule 3,  
2 page 5. Had a more normal level of labor costs been capitalized rather than  
3 expensed, the additional capitalized labor costs would have been reflected in test  
4 year plant additions. Thus, I am also recommending a corresponding adjustment  
5 to include additional capitalized labor costs in rate base. My capitalized labor  
6 adjustment increases rate base by \$441,812.

7  
8 **E. Wages, Salaries & FICA**

9 **Q. WHAT ADJUSTMENTS TO TEST YEAR LABOR EXPENSE DID**  
10 **DELMARVA PROPOSE IN THIS CASE?**

11 A. Mr. VonSteuben's adjustments increase test year payroll expenses to reflect union  
12 contract wage increases and non-union salary increases that became effective  
13 during the test year, that will become effective during 2012, and that are  
14 forecasted to become effective in 2013. Together, Mr. VonSteuben's proposed  
15 payroll increase adjustments increase test year labor expense by \$1,473,857. In  
16 addition, Mr. VonSteuben also included in his payroll expense adjustment a  
17 \$216,338 amortization allowance to recover over the next three years a \$649,013  
18 lump sum payment that Delmarva made in 2010 to IBEW Local Union Nos. 1238  
19 and 1307 as part of the labor contracts that were agree-upon with those bargaining  
20 units at that time.

21  
22 **Q. ARE ALL OF THE LABOR EXPENSE ADJUSTMENTS THAT MR.**  
23 **VONSTEUBEN PROPOSES APPROPRIATE?**

24 A. No. The 2 percent increase forecasted to become effective in February 2013 for  
25 Local 1238 union employees is not a known change in Delmarva's costs because  
26 there is no signed collective bargaining agreement at this time providing for such  
27 an increase. Similarly, the 3 percent increase effective in March 2013 for non-  
28 union employees included in Mr. VonSteuben's *pro forma* labor cost is not a  
29 known change. Presently, there is no commitment for Delmarva to increase non-  
30 union salaries by 3 percent in 2013; thus, Mr. VonSteuben's adjustment to include

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1       this forecasted increase is speculative. In addition, Delmarva has suggested that it  
2       may promptly file another rate case if some or all of its alternative ratemaking  
3       methodologies are not approved. Thus, the rate effective period may, as in the  
4       last rate case cycle, be less than one year – in which case the adjustment will be  
5       captured in the next rate case when it is actually known and measurable.  
6       Therefore, on Schedule 3, page 6 of my revenue requirement exhibit I made an  
7       adjustment to reduce Mr. VonSteuben's payroll expense claim by \$321,991 to  
8       reflect elimination of speculative wage and salary increases in 2013. My  
9       adjustment on this schedule also reduces FICA taxes by \$17,549 corresponding to  
10      my *pro forma* payroll adjustment.

11  
12      **Q.    IS THERE ANY OTHER PORTION OF MR. VONSTEUBEN'S LABOR**  
13      **COST ADJUSTMENT WITH WHICH YOU DISAGREE?**

14      A.    Yes. I object any rate recognition for the lump sum payment that Delmarva made  
15      in 2010 to IBEW Local Union Nos. 1238 and 1307 employees.

16  
17      **Q.    WHY DO YOU OBJECT TO INCLUDING THE LUMP SUM PAYMENT**  
18      **IN RATES?**

19      A.    I object to its inclusion in rates for three reasons, as follows: 1) the lump sum  
20      payment occurred outside of the test year in this case; 2) the lump sum payment is  
21      not an annually recurring expense; and 3) the Commission did not authorize  
22      Delmarva to defer the cost beyond 2010. The one-time lump sum payment does  
23      not represent a continuing revenue requirement to Delmarva. Moreover, without  
24      prior Commission approval, it is improper for the Company to hold over an  
25      expense that was incurred in a prior period. Holding over prior period expenses  
26      creates a mismatch between revenue and expense recognition and violates the  
27      matching principle, which is fundamental in both accounting and ratemaking.  
28      Therefore, I recommend that the lump sum payment made by Delmarva in 2010  
29      not be included in the Company's revenue requirement established in this  
30      proceeding. My adjustment to remove Mr. VonSteuben's proposed amortization

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allowance is shown on Schedule 3, page 6, line 12 of my revenue requirement exhibit.

**F. Employee Benefits**

**Q. WHAT INCREASES IN EMPLOYEE BENEFIT COSTS ARE REFLECTED IN THE COMPANY'S UPDATED REVENUE REQUIREMENT ANALYSIS?**

**A.** Mr. Ziminsky proposed an adjustment that increases the test year medical benefits expense by 12 percent and increases the dental and vision care benefits expense by 7.5 percent. Mr. Ziminsky explained in his testimony that the increases are based on the Company's projections of future cost trends from a survey prepared by its benefit consultant, Lake Consulting, Inc. Together, these adjustments, if approved, increase test year expenses by \$486,143.

**Q. ARE YOU IN AGREEMENT WITH MR. ZIMINSKY'S PROPOSED EMPLOYEE BENEFITS ADJUSTMENTS?**

**A.** No, I am not. Mr. Ziminsky's adjustments are not based on signed contracts that specify the post-test period costs of employee benefits. Rather, his adjustments are based on forecasts of future costs, not known changes in costs. Therefore, his employee expense adjustments are not known and measurable and should not be recognized for rate setting purposes. My adjustment to reverse the Company's claimed employee benefit cost adjustment is shown on Schedule 3, page 2b, Column B of my revenue requirement exhibit.

**G. OPEB**

**Q. DOES THE COMPANY'S PROPOSED ADJUSTMENT TO POST-RETIREMENT BENEFITS OTHER THAN PENSIONS REPRESENT A KNOWN AND MEASURABLE CHANGE IN THE COMPANY'S TEST PERIOD COSTS?**

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1     A.     No, it does not. Mr. Ziminsky's proposed OPEB adjustment is based on an  
2           estimate of the 2012 expense prepared by Delmarva's actuary. The actual OPEB  
3           costs that the Company will expense in 2012 will not be known until sometime  
4           later this year. Since Mr. Ziminsky's OPEB adjustment is based on a forecast  
5           rather than a known cost change, Mr. Ziminsky's adjustment to the test year  
6           expense should not be included in Delmarva's revenue requirement. I reversed  
7           Mr. Ziminsky's proposed \$144,852 OPEB expense adjustment on my Schedule 3,  
8           page 2b, Column C.

9  
10           **H.     Pension**

11     **Q.     DID MR. ZIMINSKY ADJUST TEST YEAR PENSION COSTS IN THE**  
12           **SAME MANNER AS HE DID WITH OPEB COSTS?**

13     A.     Not exactly. Mr. Ziminsky's adjustment to the test year OPEB expense relied on  
14           a forecast of the 2012 expense. For the pension expense, however, Mr.  
15           Ziminsky's proposed adjustment is based on the two-year average (2010-2011) of  
16           pension costs. Mr. Ziminsky testified that the Company will replace this  
17           adjustment with one based on the actual known cost for 2012 once it becomes  
18           available from Delmarva's independent actuary.

19  
20     **Q.     DO YOU SUPPORT MR. ZIMINSKY'S PENSION ADJUSTMENT?**

21     A.     No, I do not. I agree with Mr. Ziminsky to the extent that any adjustment to  
22           pension should be supported by Delmarva's actual, known costs. But, as Mr.  
23           Ziminsky points out in his testimony, that determination for 2012 is not yet  
24           available. Moreover, there is no representation that the two-year average pension  
25           expense, reflected in Mr. Ziminsky's proposed adjustment, will equal the 2012  
26           expense. That is, the two-year average is not a known change. Therefore,  
27           without having the 2012 pension cost study available now, the best approximation  
28           of Delmarva's continuing revenue requirement for pension costs is the test year  
29           expense itself. I reversed Mr. Ziminsky's proposed adjustment on my Schedule 3,

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1 page 2b, Column D. My adjustment reduces Delmarva's claimed expenses by  
2 \$119,531.  
3

4 **I. Non-Executive Incentive Compensation**

5 **Q. DOES DELMARVA'S CLAIMED REVENUE REQUIREMENT INCLUDE**  
6 **ANY AMOUNTS FOR INCENTIVE COMPENSATION PAID DURING**  
7 **THE TEST PERIOD?**

8 A. Yes, it does. Even though Mr. VonSteuben proposed an adjustment that removed  
9 amounts paid during the test period under the Executive Incentive Compensation  
10 program, there still remains in the revenue requirement \$1,406,498 for incentive  
11 payments made during the test period under the 2011 Annual Incentive Plan  
12 applicable to Delmarva's and PHI Service Company's non-executive managers.  
13

14 **Q. IS IT APPROPRIATE FOR THE COMPANY TO HAVE INCENTIVE**  
15 **COMPENSATION PLANS?**

16 A. Incentive pay has become prevalent in many industries, including public utilities.  
17 Generally, I do not have a problem with utilities motivating key employees  
18 through incentive compensation plans. I have not objected to recognizing in rates  
19 incentive compensation costs incurred under plans that were designed to promote  
20 employee safety and ratepayer interests. On the other hand, I have consistently  
21 objected to recognizing in utility rates bonus payments made under plans that  
22 were primarily designed to promote shareholder interests rather than ratepayer  
23 interests. It is especially objectionable that some incentive compensation plans,  
24 including PHI's Annual Incentive Plan, provide perverse incentives for the utility  
25 to overstate its revenue requirement and to maintain excessive rates.  
26

27 **Q. IS IT REASONABLE TO CONCLUDE THAT THE PURPOSE OF PHI'S**  
28 **ANNUAL INCENTIVE PLAN IS TO PROMOTE EMPLOYEE SAFETY**  
29 **AND RATEPAYER INTERESTS RATHER THAN SHAREHOLDER**  
30 **INTERESTS?**



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1 A. No, there is no support for that conclusion. The Company's plan is a prime  
2 example of where the interests of stockholders are placed far above those of  
3 Delaware ratepayers. Therefore, it is not appropriate to recognize in rates any  
4 costs incurred under the plans because of the way that PHI has structured the  
5 Annual Incentive Plan.

6  
7 Under the Annual Incentive Plan in effect during 2011, total performance payouts  
8 were first determined by how well the Company and/or PHI meet pre-established  
9 financial earnings goals. That is, the plan placed a threshold hurdle on the  
10 Company's ability to make performance-related payouts regardless of whether  
11 other financial, safety or operational individual or team goals were met. For  
12 Utility Operations employees, Utility Operations' earnings had to have reached a  
13 93 percent threshold to qualify for any potential payout. For Corporate Service  
14 employees, corporate earnings had to be at least 90 percent of the pre-established  
15 target. These thresholds had to be met before any performance payouts are made.  
16 If the financial threshold goals were met, employees were then eligible to earn  
17 additional performance payments for meeting or exceeding other pre-established  
18 individual or group safety and operational goals. But, even if all other individual  
19 or team goals had been met or exceeded, no incentive payments would have been  
20 made unless the minimum financial threshold targets were also met.

21  
22 **Q. ON WHAT BASIS DO YOU CONCLUDE THAT THE COMPANY'S 2011**  
23 **ANNUAL INCENTIVE PLAN WAS PRIMARILY DESIGNED TO**  
24 **PROMOTE STOCKHOLDER INTERESTS RATHER THAN**  
25 **RATEPAYER INTERESTS?**

26 A. There is no reasonable conclusion other than that this plan was primarily designed  
27 to promote shareholder interests given that it requires the Company and or PHI to  
28 achieve threshold levels of earnings before any incentive payments are made.  
29 That is, Delmarva must first satisfy shareholders by producing sufficient earnings  
30 before eligible employees are rewarded for achieving other financial and

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1 operational goals. If Delmarva and PHI were more concerned about providing  
2 incentives for achieving employee and public safety or ratepayer services and  
3 satisfaction goals, for example, there would be no earnings threshold as a  
4 necessary pre-condition. Thus, it is clear that the paramount goal of the Annual  
5 Incentive Plan was to increase shareholder wealth. This goal is inconsistent with  
6 ratepayers' goal of receiving service at the lowest reasonable price. In fact, there  
7 is a perverse incentive in the Annual Incentive Plan for the Company to  
8 artificially inflate requests for rate relief, to maintain excessive rate levels and to  
9 suppress operating expenses and capital investment. Since stockholders are the  
10 primary beneficiaries when the Company achieves the financial threshold,  
11 stockholders rather than Delaware ratepayers should pay for the incentive awards.  
12 Therefore, I recommend that incentive payments made under the Annual  
13 Incentive Plan during the test period be excluded from Delmarva's recoverable  
14 costs in this proceeding. My position is consistent with the Commission's  
15 decision in Docket No. 09-414 on this issue. My adjustment to exclude these  
16 payments is shown on Schedule 3, page 2b, Column E in my revenue requirement  
17 exhibit.

**J. Storm Restoration Expense**

20 **Q. HOW HAVE STORM-RELATED EXPENSES BEEN REFLECTED IN**  
21 **THE COMPANY'S REVENUE REQUIREMENT IN THE PAST?**

22 A. Mr. VonSteuben states that in the Company's 2009 rate case (Docket No. 09-414)  
23 the test period storm restoration expense was replaced with a normalized level of  
24 the expense that was calculated using a recent three-year average storm  
25 restoration expense.

27 **Q. IS THIS THE SAME TREATMENT THAT MR. VONSTEUBEN**  
28 **PROPOSED IN THIS PROCEEDING?**

29 A. No, not exactly. Mr. VonSteuben segregated all of Delmarva's other storm-  
30 related costs from those costs incurred by the Company for cleanup and

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1 restoration activities relating to Hurricane Irene. Mr. VonSteuben adjusted the  
2 test year level of non-Hurricane Irene storm restoration expense to reflect the  
3 three-year average. For the \$3,394,217 of Hurricane Irene costs, however, Mr.  
4 VonSteuben proposes to amortize the expense over the next three years and to  
5 include the average unamortized balance, net of tax, in rate base.

6  
7 **Q. DO YOU AGREE WITH MR. VONSTEUBEN'S STORM RESTORATION**  
8 **ADJUSTMENTS?**

9 A. No, not entirely. Storms are unusual and unpredictable and the cost incurred by a  
10 utility in cleanup and service restoration activities can vary widely year-by-year.  
11 Therefore, the Commission has chosen to normalize rather than amortize storm-  
12 related costs in the rate setting process. By definition, however, each storm event  
13 is unusual and nonrecurring. Thus, there is no logic in segregating costs for a  
14 single storm in the manner that Mr. VonSteuben proposes for Hurricane Irene.  
15 Nor is it appropriate to implement special rate treatment for one such event when  
16 the costs of all other events are already being normalized for rate setting purposes.

17  
18 **Q. WHAT DO YOU RECOMMEND?**

19 A. All costs incurred in connection with all storms should be added together and  
20 averaged over a three-year period to determine the normalized annual expense  
21 level for rate setting purposes. The three-year average normalization treatment  
22 previously followed by the Commission for storm restoration costs is a sound  
23 ratemaking policy if followed consistently through time. A three-year average  
24 will reflect the actual high and low annual expense over the prior three years,  
25 which historically has been the interval between expected rate filings for  
26 Delmarva. In this case, it happens that in one of those three years included in the  
27 average, the Company's storm-related costs were relatively high because of  
28 Hurricane Irene. Those unusually high costs that occurred during 2011, however,  
29 are factored into the normalized rate allowance using the three-year average  
30 normalization method. No other special treatment for Hurricane Irene-related

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1 costs is necessary or appropriate. Since Delmarva is likely to file another rate  
2 case very soon and almost certainly before three years, the Company's Hurricane  
3 Irene costs will likely be included in a normalization adjustment in the next rate  
4 case as well. Therefore, there is little chance that the three-year average  
5 normalization method previously adopted by the Commission for storm  
6 restoration costs will leave Delmarva with a large unrecovered storm-related cost  
7 over time. The three-year average normalization method, including all storm  
8 events, is reasonable. There is no support for affording special treatment for  
9 Hurricane Irene costs.

10  
11 **Q. PLEASE DESCRIBE YOUR STORM RESTORATION ADJUSTMENTS.**

12 A. On Schedule 3, page 7 of my revenue requirement exhibit I calculated Delmarva's  
13 Delaware retail three-year average storm restoration expense, including Hurricane  
14 Irene-related costs. This amount replaces the normalized expense included by  
15 Mr. VonSteuben in Delmarva's updated revenue requirement analysis. On  
16 Schedule 3, page 2b, Column G, I reverse the separate adjustment that Mr.  
17 VonSteuben proposed for Hurricane Irene costs since I have included Hurricane  
18 Irene costs in my three-year average normalization adjustment. Also, since I am  
19 recommending that the Commission continues to normalize storm-related  
20 expenses rather than amortize them, on Schedule 2, page 2a, Column H, in my  
21 revenue requirement exhibit I reversed the rate base adjustment that Mr.  
22 VonSteuben proposed for Hurricane Irene costs.

23  
24 **K. Deferred IRP Amortization**

25 **Q. MR. ZIMINSKY TESTIFIES THAT THE COMMISSION APPROVED**  
26 **DEFERRAL ACCOUNTING AND A 10-YEAR AMORTIZATION FOR**  
27 **COSTS INCURRED PRIOR TO JULY 2009 ASSOCIATED WITH**  
28 **DELMARVA'S INITIAL INTEGRATED RESOURCE PLAN ("IRP"). IS**  
29 **THE COMPANY NOW PROPOSING ADDITIONAL COST RECOVERY**  
30 **FOR ITS INITIAL IRP?**

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1     A.     Yes. Beginning in August 2009, Delmarva incurred an additional \$101,944 of  
2           costs associated with its initial IRP. Mr. Ziminsky proposes to amortize this  
3           amount over the next ten years and to include the average unrecovered balance,  
4           net of taxes, in rate base.

5  
6     **Q.     DO YOU AGREE WITH MR. ZIMINSKY'S PROPOSED RATE**  
7           **MAKING TREATMENT FOR THESE IRP COSTS?**

8     A.     No. In a separate adjustment, Mr. Ziminsky proposed to normalize IRP costs for  
9           rate making purposes going forward. By his amortization adjustment, however,  
10          Mr. Ziminsky intends to recover costs incurred in an accounting period prior to  
11          the test period even though the Commission did not authorize deferred accounting  
12          treatment for the expense. Doing so will create a mismatch between test period  
13          income and expense recognition and constitute a violation of the matching  
14          principle. Expenses should be charged against earnings in the period in which  
15          they were incurred and not held over to the future so that they can be explicitly  
16          included in a rate filing unless the Company received prior approval from the  
17          Commission to defer recognition of the expense. My adjustments to reverse Mr.  
18          Ziminisky's proposed amortization allowance reduce Delmarva's claimed  
19          expenses by \$10,194, and rate base by \$57,474.

20  
21          **L.     Deferred RFP Amortization**

22     **Q.     WHAT IS YOUR ISSUE WITH DELMARVA'S PROPOSED RFP**  
23           **AMORTIZATION EXPENSE ALLOWANCE?**

24     A.     Similar to his proposed treatment of IRP costs incurred during 2009, Mr.  
25          Ziminsky is proposing to amortize over the next 15 years expenses incurred  
26          beginning August 2009 associated with the Company's RFP process. Mr.  
27          Ziminsky also included the unamortized balance, net of taxes, in rate base. My  
28          issue with these adjustments is the same as my issue with Mr. Ziminsky's  
29          proposed IRP amortization. As I understand, the Commission authorized a  
30          deferral of cost recognition for Delmarva's RFP costs incurred prior to August

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1        2009. That authorization did not extend beyond July 31, 2009. Without  
2        additional authorization to deferred costs beginning in August 2009, the RFP  
3        costs should have been recognized on the Company's books as a 2009 expense  
4        and should not be considered for ratemaking treatment today. My adjustments,  
5        shown on my Schedule 3, page 2c, Column B, reverses Mr. Ziminsky's proposed  
6        \$5,078 amortization expense adjustment. On my Schedule 2, page 2b, Column C,  
7        I reversed Mr. Ziminsky's proposed \$28,631 rate base adjustment.

8  
9        **M.     Postage Expense**

10      **Q.     WHAT ADJUSTMENT IS DELMARVA PROPOSING TO TEST YEAR**  
11      **POSTAGE EXPENSE?**

12      A.     Mr. Ziminsky proposed an expense adjustment to annualize the impact of a  
13      projected postage rate increase effective in January 2012. Mr. Ziminsky's  
14      proposed adjustment represents a \$76,884 increase in Delaware distribution  
15      operating expenses. Mr. Ziminsky has indicated that he will update his  
16      adjustment at a later date.

17  
18      **Q.     ARE YOU IN AGREEMENT WITH MR. ZIMINSKY'S PROPOSED**  
19      **POSTAGE EXPENSE ADJUSTMENT?**

20      A.     No, I am not. Mr. Ziminsky's proposed adjustment seeks recognition of a post-  
21      test period cost increase without considering the effects that post-test year volume  
22      changes are likely to have on the Company's annual postage expense.  
23      Specifically, an increase in electronic bill payment may offset some or all of the  
24      post-test year postage rate increase. Therefore, I am opposed to recognizing only  
25      a postage rate change without also considering offsetting reductions in postage  
26      costs arising from increasing numbers of customers paying bills electronically.

27  
28      **Q.     PLEASE DESCRIBE YOUR ADJUSTMENT TO MR. ZIMINSKY'S**  
29      **CLAIMED *PRO FORMA* POSTAGE EXPENSE.**

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1     A.     My adjustment is in two parts. First, I eliminated the effects of the projected  
2             January 2012 postage rate increase that was included in Mr. Ziminsky's  
3             adjustment. In addition, I annualized the impact of the postage rate change that  
4             occurred during June of the test year. Thus, my recommended allowance for  
5             postage expense reflects the annualized postage rates that became effective in  
6             June 2011 as applied to Delmarva's actual test year volume of mail. My  
7             recommended adjustment reduces Mr. Ziminsky's claimed postage expense by  
8             \$54,256, as is detailed on my Schedule 3 page 8 of my revenue requirement  
9             exhibit.

10

11             **N.     Credit Facility**

12     **Q.     WHAT IS DELMARVA REQUESTING IN THIS PROCEEDING**  
13             **RELATIVE TO THE PHI CREDIT FACILITY?**

14     A.     Mr. Ziminisky explained in his testimony that on August 1, 2011, PHI renewed its  
15             credit facility, from which it receives short-term financing, for a five-year term.  
16             Thus, Mr. Ziminsky proposed an adjustment to amortize Delmarva's allocated  
17             share of the start-up costs and the annual cost of maintaining the credit facility in  
18             rates.

19

20     **Q.     DO YOU AGREE WITH MR. ZIMINSKY'S PROPOSED ADJUSTMENTS**  
21             **RELATING TO THE PHI CREDIT FACILITY?**

22     A.     No, I do not. Mr. Ziminsky states that the credit facility costs are recorded on  
23             Delmarva's books as an interest expense. It is important to recognize that the  
24             credit facility costs are a cost associated with securing short-term debt financing.  
25             Short-term debt, however, is not included in the Company's capital structure.  
26             Rather, under the Uniform System of Accounts, Delmarva first assigns short-term  
27             debt to construction work in progress. This assignment is recognized in the  
28             AFUDC rate, which Delmarva capitalizes to its construction accounts. Therefore,  
29             rather than including the PHI credit facility costs in current rates as Mr. Ziminsky  
30             proposes, the proper treatment of these costs is to recognize them as an increase in

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1 the effective cost of short-term debt in the calculation of Delmarva's AFUDC  
2 rate. In that way, Delmarva will be appropriately compensated for its credit  
3 facility costs in the Company's AFUDC rate, which is the manner intended under  
4 the Uniform System of Accounts. I recommend that both the test year level of  
5 credit facilities costs as well as Mr. Ziminsky's PHI credit facility cost  
6 adjustments be reversed. My adjustments that accomplish this reversal are shown  
7 on my Schedule 3, page 2c, Column D.

8  
9 **O. Customer Information System**

10 **Q. DOES THE \$185,323 ADJUSTMENT THAT MR. ZIMINISKY PROPOSED**  
11 **FOR THE NEW CUSTOMER INFORMATION SYSTEM THAT THE PHI**  
12 **BOARD OF DIRECTORS RECENTLY APPROVED REFLECT A**  
13 **KNOWN AND MEASURABLE CHANGE AT THIS TIME?**

14 **A.** No, it does not. As an initial matter, there was no support provided by Delmarva  
15 for the claimed increase in expenses. More important, it is inappropriate to reflect  
16 a cost increase associated with the new Customer Information System at this time  
17 because there has been no recognition of the related service benefits and cost  
18 savings flowing through to Delaware customers. Indeed, Mr. Ziminsky explains  
19 in his Direct Testimony in this case that the new Customer Information System  
20 will not be implemented until May 2012 through 2014. Without some  
21 quantification of service benefits and cost reductions flowing from the new  
22 system, it is wrong to reflect any cost increases. Obviously, the service benefits  
23 cannot be quantified until the system has been implemented. Thus, there is no  
24 support for recognizing in rates Mr. Ziminisky's Customer Information System  
25 adjustment. I reversed Mr. Ziminsky's proposed \$185,323 adjustment on my  
26 Schedule 3, page 2c, Column E.

27  
28 **P. CUSTOMER CARE EXPENSE**



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1   **Q.   PLEASE EXPLAIN THE ADJUSTMENT THAT YOU SHOW FOR**  
2       **CUSTOMER CARE EXPENSE ON YOUR SCHEDULE 3, PAGE 2C,**  
3       **COLUMN F.**

4   **A.**   This adjustment removes the Delaware electric distribution portion of the  
5       \$100,000 expense claimed by Delmarva for customer education in Adjustment 16.  
6       Staff witness Mr. Hartigan is sponsoring this adjustment.

7  
8       **Q.   Qualified Fuel Cell Provider Projects**

9   **Q.   WHAT ADJUSTMENT ARE YOU RECOMMENDING TO THE**  
10       **AMOUNTS CLAIMED IN THE COMPANY'S FILING RELATING TO**  
11       **THE QUALIFIED FUEL CELL PROVIDER PROJECTS?**

12   **A.**   Mr. Ziminsky adjusted test year expenses to reflect a three-year amortization of  
13       the fuel cell provider project related costs. My adjustment, shown on Schedule 3,  
14       page 2c, Column G, removes Mr. Ziminsky's proposed amortization allowance. I  
15       have been advised that the Commission will consider Delmarva's costs in a  
16       separate proceeding, Docket No. 12-173-05. Therefore, it is appropriate to  
17       exclude both Mr. Ziminsky's proposed amortization allowance and the actual test  
18       year expense from base rates in this proceeding.

19  
20       **R.   AFUDC**

21   **Q.   WHAT IS THE BASIS FOR THE AFUDC ADJUSTMENT THAT YOU**  
22       **SHOW ON EXHIBIT\_\_\_(DEP-1), SCHEDULE 3, PAGE 2D?**

23   **A.**   I explained earlier in my testimony that Delmarva's claimed revenue requirement  
24       analysis includes CWIP in rate base. It also includes the test year AFUDC  
25       balance as a credit to operating income. Thus, in the Company's revenue  
26       requirement analysis, AFUDC is a partial, albeit a non-compensatory, offset to the  
27       revenue requirements associated with including CWIP in rate base. Since it is my  
28       recommendation that CWIP be excluded from rate base, it is also appropriate to  
29       remove the AFUDC income credit. My adjustment decreases test year operating  
30       income by \$950,339.

David E. Peterson/Direct Testimony

**S. Interest Synchronization**

**Q. PLEASE EXPLAIN THE INTEREST SYNCHRONIZATION  
ADJUSTMENT THAT YOU SHOW ON SCHEDULE 3, PAGE 9.**

**A.** This schedule shows the required adjustment to state and federal income taxes to synchronize the interest expense tax deduction with the debt portion of the overall return requirement that Mr. Parcell is recommending. The pro forma tax deduction for interest expense is the product of the weighted cost of debt and my rate base determination and results in a \$647,173 increase in income taxes currently payable.

**T. Summary of Revenue Requirement**

**Q. WHAT IS THE COMBINED EFFECT OF THE COMMISSION STAFF'S  
RECOMMENDED ADJUSTMENTS TO DELMARVA'S UPDATED  
CALCULATION ITS REVENUE REQUIREMENT FOR THE TEST  
PERIOD ENDED DECEMBER 31, 2011?**

**A.** As shown on my Schedule 3, page 1, Delmarva calculated *pro forma* earnings under present rates of \$27,493,512 for the adjusted test period ended December 31, 2011. Together, the Commission Staff's recommended income adjustments add \$1,982,287 to Delmarva's claimed *pro forma* earnings. Thus, I calculate that Delmarva's present revenues generate \$29,475,799 of earnings under *pro forma* conditions for the test period and a 5.52 percent return on the test year average rate base.

Commission Staff witness Mr. Parcell determined that Delmarva requires a 9.55 percent return on common equity capital and a 7.28 percent overall return on rate base. Rate levels will have to be increased by \$15,883,075 to produce a 7.28 percent overall rate of return for Delmarva. Therefore, I recommend that Delmarva's proposed rate schedules be rejected and that the Company be ordered

**David E. Peterson/Direct Testimony**

1 to file new rate schedules reflecting the lower revenue requirement that the  
2 Commission Staff has determined is necessary at this time.

3

4 **Q. DOES THIS COMPLETE YOUR TESTIMONY AT THIS TIME?**

5 **A.** Yes, it does.